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The Northampton Retirement Board

N E W S L E T T E R

July 2014

News for our retirees and members-in-service

Funding progress seen in 2014 valuation study

Favorable market conditions in recent years have helped improve the funded ratio of the Northampton Retirement System after several years of downturn. After dropping in 2008, the funded level of the System has been increasing over the last two valuations. On the 2013 market value of assets, the System is currently 67.6% funded, up from 60.8% at the time of the last study two years ago.

Although investment returns have exceeded assumptions in eight of the last ten years, the market crash of 2008 essentially stalled progress on the System's funding schedule until this year. The reason for this is the manner in which gains and losses are commonly recognized in public defined benefit pension systems over a four to five-year period, called *asset smoothing*, in order to reduce volatility in annual municipal appropriation requirements.

With asset smoothing, losses are spread out over several years. Some people believe that this favors a long-term overvaluation of assets, even though gains are spread out as well. Any single year of spectacular investment return, is not going to get counted all at once with asset smoothing. For the Northampton Retirement System, the spread of gains and losses over the past four years have *reduced* the actual current value of assets. The figure resulting from this smoothing is called the *actuarial value of assets*. A gain is defined as an increase to the fund which is greater than the assumed rate of return; in our case that is 7.75%. Any return that is less than the target is an actuarial loss. This technique is used to determine the amount of money that is actuarially available to fund the System. Actuaries then predict the amount of existing pension liability using a detailed methodology, and with that, determine the funding requirements.

After factoring in four-year asset smoothing, the System's 2013 assets reduce from $101 million to about $94 million. Note that differing lengths of asset smoothing, one of greater or less duration, or no smoothing at all, will affect the actuarial value of assets of a pension system, and hence, the reported funded level.

The chart on the following page chart demonstrates the effect of asset smoothing over each Northampton valuation since 2004. Note the increased volatility of smoothed assets versus actual market value. Instead of following the spikes of the actual market value line, the amount of annual appropriations required to pay down the unfunded liability follows a smoothed line, resulting in a less volatile funding schedule (outside of other assumptions). The average deviation of smoothed assets from actual assets over this ten year period was less than 1%, favoring a slight *undervaluation* of market assets.

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The Northampton Retirement Board

MEMBERS OF THE BOARD

- **Joyce Karpinski**
  Chairperson, Ex-Officio Member
- **Shirley LaRose**
  Elected Member
- **Michael Lyons**
  Elected Member
- **Thomas Sullivan**
  Appointed "Fifth" Member
- **Susan Wright**
  Vice-Chair, Appointed Member

RETIREMENT BOARD STAFF

David Shipka
Administrator

Elsie Irizarry
Administrative Assistant

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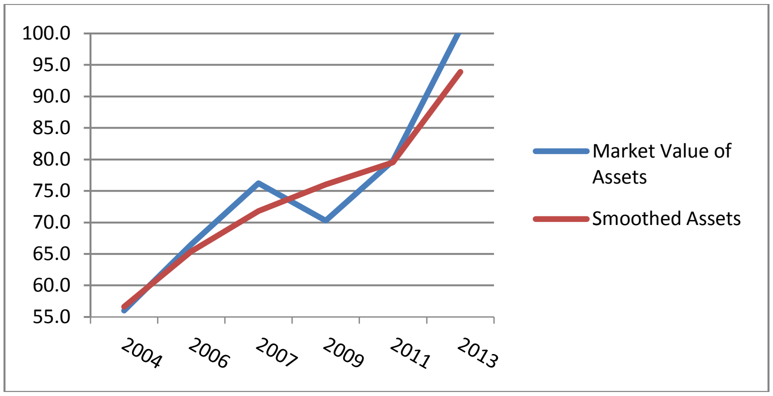


While achieving the target rate of investment return is crucial to paying down a pension system's unfunded liability, there are many factors that substantially influence the assessment of that liability. One important element is the mortality table used. As people live longer, more benefits are paid and pension systems must recognize the resulting liability. In the current valuation study, the Board has taken the conservative approach of adopting the latest mortality assumptions. While these assumptions result in an immediate increase to the System's accrued liability and reduce the apparent funded ratio, a figure widely used to measure (and sometimes disparage) the health of a pension system, staying ahead of the assumption curve will reduce costs down the road. The Northampton Retirement Board is focused on the continuing implementation of best practices for paying down the unfunded liability.

Looking forward, a factor that will significantly help fund the System will be the altered benefit structure passed by the State Legislature for members hired after April 1, 2012. Although the decrease in liability resulting from this is currently rather small, the savings from these pension reform measures will greatly increase in the coming years. If market conditions continue to exceed assumptions, these savings may allow for a reduction of the funding schedule length.

Below is a comparison of key figures from the current and previous biennial valuation.

Valuation date	**1/1/2012**	**1/1/2014**
Market value of assets	$79.8 million	$100.7 million
Actuarial accrued liability	$131.4 million	$149.0 million
Funded ratio	60.8%	67.6%
Actuarial value of assets	$79.5 million	$93.9 million
Funded ratio (actuarial value)	60.5%	63.0%
Funding schedule length	23 years	21 years
Assumed investment return*	7.75%	7.75%

*Annualized investment returns have exceeded 12% over five years, 8% over ten years, and 9% since mandatory funding of future pension liabilities began 29 years ago.

Health Insurance Reform Bill Update

After receiving a considerable amount of opposition from public workers throughout Massachusetts, legislation (HB59) designed to save money by significantly reducing post-retirement healthcare benefits for many public workers has stalled in the current legislative session. The issue is likely to be taken up again next year. As new information becomes available we will post it on our website.

If you need to...

- ✓ Change your designated beneficiary,
- ✓ Update your address or telephone number,
- ✓ Purchase creditable service for prior part-time employment or refunded membership,
- ✓ Request information on your future benefits,
- ✓ Plan a retirement date and file your application,

... call us at 587-1211.

- ✓ Your annual retiree affidavit will be mailed in December and we urge you to return it promptly to avoid a disruption of benefits.
- ✓ Look for your 2014 1099-R tax form to arrive by January 31, 2015.
- ✓ For annual allowance and deduction totals, save your December paystub.
- ✓ Keep track of any post-retirement public earnings to make sure you stay within your allowable earnings limits.
- ✓ Keep us informed of changes to your address or telephone number.
- ✓ Sign up for deposit if you haven't already. Imagine no monthly trips to the bank and waiting for the mail delivery.

Retiree COLA increase for 2014

The Northampton Retirement Board again voted unanimously this year to grant the maximum allowable cost-of-living adjustment (COLA) to retirees. By law, the increase is limited to the first $13,000 of your annual retirement allowance, or $390.00. The effective date of the increase is July 1st and is payable beginning July 31st. To be eligible for this year's increase you must have retired prior to July 1, 2013.

Michael Lyons begins fourth elected term

Michael Lyons ran unopposed for re-election to the Retirement Board and began his fourth term on July 1st. Prior to retiring in 2002 he served for 19 years as City Auditor, a position under which he also served as the ex-officio board member.

Visit us at our new location on the first floor of Memorial Hall.

Northampton Retirement Board
240 Main Street, 1st Floor
Northampton, MA 01060

About the Retirement Board

The Northampton Retirement Board became operative on July 1, 1937 and is one of 106 retirement systems operating independently to provide defined benefits for public employees under Massachusetts General Laws Chapter 32.

Governance:

In local retirement systems, the city auditor or other official having similar duties is the ex-officio board member. The second member is appointed by the city mayor or board of selectmen. The third and fourth members are elected by the retirees and active members of the system. The fifth member is chosen by the other four and must be independent of the system. One of the five members is chosen by the others to serve as Chairperson.

- **Joyce Karpinski** (Chairperson), Ex-Officio Member, City Auditor
- **Susan Wright,** Appointed Member, City Finance Director
- **Shirley LaRose,** Elected Member, City Treasurer (retired)
- **Michael Lyons,** Elected Member, City Auditor (retired)
- **Thomas Sullivan,** Appointed "Fifth" Member (private financial advisor)

Staff:

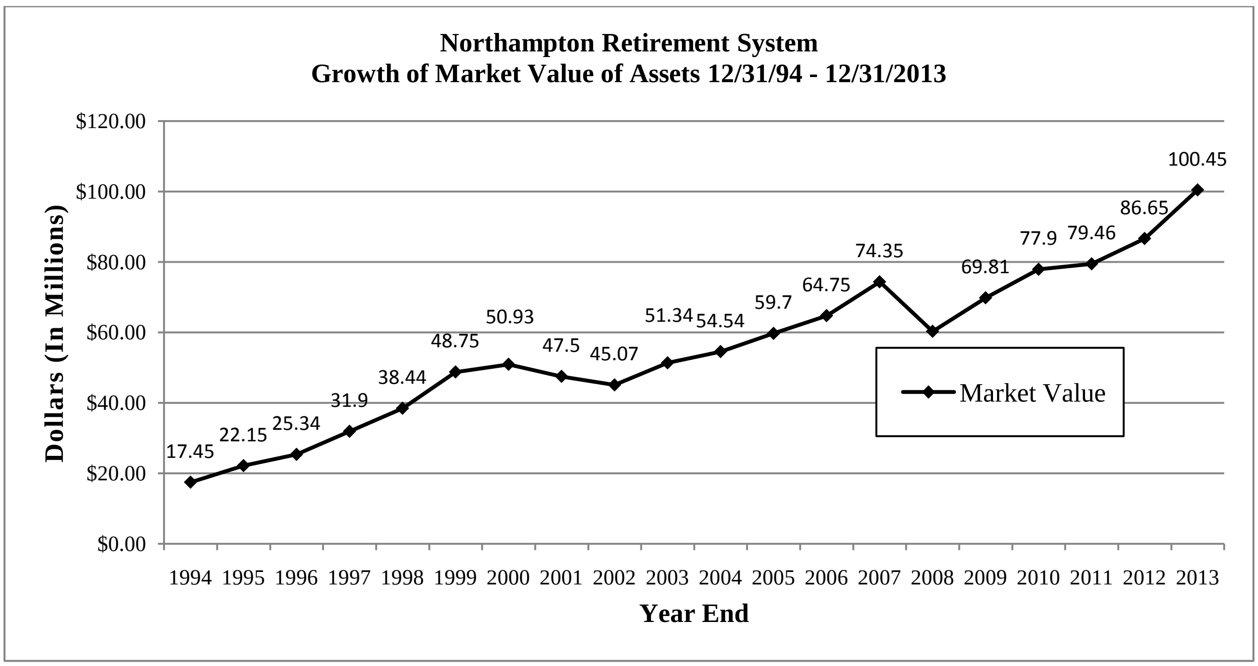
- **David Shipka** – Administrator
- **Elsie Irizarry** – Administrative Assistant

Investment Report for 2013

Prepared for our members by our investment advisor, the de Burlo Group, Inc.

The stock market was quite strong during 2013, with the Standard & Poor's 500 Stock Index returning approximately 32%. By comparison, the stocks in the Northampton Retirement System performed well, up approximately 30%. The entire portfolio (including stocks and bonds) of the Northampton Retirement System also had good results, returning over 18% for the year.

As the graph below shows, the System's assets reached a new peak of $100.45 million at the end of December, 2013, an increase of $13.8 million over the year earlier level. Growth in value over the last three years has come from investment returns rather than net new appropriations.



For 2013, the Northampton System performance was excellent, up 18.1%. Such performance for Northampton compares favorably to the 15.2% return of the Public Retirement Investment Trust (PRIT), the State's pension fund. For the past five years Northampton's assets compounded at an average rate of 12.3% per year, better than the 11.9% annual return earned by PRIT. For the past 10 years, Northampton has earned 8.2% per year, or above PRIT's 7.6% return. (The System's returns reported in this report may differ slightly from the returns that PERAC reports due to differences in methodology.)

Although the sharp decline in 2008 limited average annual returns for more recent periods, the System's returns over the long term demonstrate the System's sustainability. During the 29 years that PERAC has been tracking performance of Massachusetts municipal pension funds, the Northampton Retirement System has earned an annualized return of approximately 9.7%. Northampton's annual appropriation to the Retirement System and the funding schedule projected for the System are based upon an assumed rate of return of 7.75%. The 9.7% annualized return the System has earned over the 29 years is well in excess of that. Furthermore, Northampton's return is on par with PRIT's 9.8% per year over the past 29 years.

The Northampton Retirement System Portfolio

The assets of the Northampton System remain well diversified as the table below shows. During the year our investment adviser increased stocks from 61% of the total portfolio to 68% with an emphasis on increasing domestic stocks. Conversely, they lowered the commitment to bonds from about 36% of the portfolio to 30%, locking in gains from rising bond prices, helped by Federal Reserve policy.

	Allocation at 12/31/13	$ Millions	% of Total
Cash	**Cash**	**0.63**	**0.6**
	Domestic Stock	59.69	59.4
	International Stock	8.12	8.1
	Real Estate	-	-
Equity	**Total Equity**	**67.82**	**67.5**
	Domestic Bonds	26.32	26.2
	International Bonds	2.02	2.0
	Below Invest. Grade	2.01	2.0
Fixed Income	**Total Fixed**	**30.35**	**30.2**
	Hedge Funds	0.84	0.8
	Private Equity & Venture Capital	0.80	0.8
PRIT Investments	**Total PRIT Investments**	**1.64**	**1.6**
Total		**100.44**	**100.0**

Totals may not add due to rounding.

The Financial Markets in 2013

In 2013, the stock market continued its upward trend set during the prior year. The results were quite good through May of this year, followed by a brief dip in June. The second half of the year was also good, moving higher from October through the remainder of the year. In fact, the market returns were positive during each quarter of the year, with the first and last quarters of 2013 exhibiting the most strength.

For 2013 most stocks did quite well, except for those in emerging markets. Domestic stocks that exhibit higher volatility, such as small capitalization and technology stocks did the best. For example, the Russell 2000, an index of smaller capitalization stocks, was up 37% during 2013. NASDAQ, the index heavy in technology and biotech stocks, also did well, up 38% during the year. Developed international market stocks had decent performance, up just below 20%. By contrast, the MSCI Emerging Markets Index was negative, down more than 5% during the year. Gold was a major underperformer, down nearly 28%.

The stock markets continued to rally again this past year, helped by low interest rates set by central banks not only in the U.S. but also in other countries throughout the globe. Additionally, a firming US economy and good corporate earnings helped to propel stocks higher.

The Economy and Outlook for 2014

The US economy grew by approximately 2.6% during 2013. Although this represents a slow, yet steady pace, other economic recoveries over recent decades have been much more robust. A moderate improvement in employment appears to have held back consumer spending during 2013. Housing and consumer confidence were both positive, but not strong enough to get consumers to spend.

The economic outlook for 2014 looks somewhat better. Although the first quarter was weak due to extremely cold weather, many economists expect a strong second half of the year. Improving labor markets, housing, and consumer spending will likely push the economy forward. As a result of historically low interest rates, borrowing costs remain low for both corporations and individuals. In addition, energy prices are low and stable.

Payrolls surged in April by 288,000 and represent the best results since January of 2012. Unemployment in April also declined from 6.7% to 6.3%. Even though the participation rate—or the number of individuals in the workplace—is stuck at decades lows, many workers have decided to retire rather than return to the labor force. Additionally, jobless claims continue to edge down to levels reached only in 2007 at the peak of the last economic cycle. We expect continued improvement in the jobs market.

Housing continues to improve, but not as robustly as in previous months. The decline in price appreciation is due to the fact that affordability has worsened for many buyers, especially for first time buyers who usually represent at least a third of existing sales. Sales of existing homes have declined due to low inventory as well. Much needed credit appears to be flowing in the economy. Commercial and industrial loan activity has improved and is up 19% through April. Also, the services sector accelerated during April at the fastest clip in 8 months. Manufacturing in May is up for the fourth month in a row and many companies are reporting expanding business activity.

The retail sector results in the US have been somewhat muted year-to-date. Consumers have been slow to increase spending in an environment in which the employment picture is improving only moderately. Also, harsh weather conditions slowed activity. Although the Consumer Confidence Index rose in May, the survey indicated that consumers remain cautious, due in large part to the fact that many individuals do not expect rising incomes in the next six months. The outlook appears to be more optimistic for the later in 2014 and into 2015. A primary driver is the increase of nearly $10 trillion in household wealth that occurred in 2013. Estimates are that this wealth gain could raise the annual level of consumer spending by nearly $400 billion. This magnitude of spending could be enough to raise total GDP growth by approximately one percentage point.

The European economy appears to be improving. Green shoots were evident in the summer of last year and growth is currently flat to moderately positive in most of the Eurozone. Even the worst hit countries such as Portugal, Italy, Spain, and Greece have experienced stabilization. However, unemployment and housing in Spain are still problematic, as negative equity and high foreclosure rates have held back economic recovery. Manufacturing in China has grown more than expected in the fifth month for three straight months in a row. The world's second largest economy has proven to be resilient and may continue to be an important component in the global recovery.